MINUTES

BOARD OF TRUSTEES
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 500
Indianapolis, IN 46204

April 17, 2000

TRUSTEES PRESENT

Nancy Turner, Vice Chair
Steven Miller
Jonathan Birge

TRUSTEES ABSENT

Richard Doermer, Chair
Dr. Teresa Ghilarducci

OTHERS PRESENT

Mike Gery, Executive Assistant to the Governor
Diana Hamilton, Special Liaison to the Governor for Public Finance
Mary Beth Braitman, Ice Miller Donadio & Ryan
Steffanie Rhinesmith, Indiana Development Finance Authority
Pete Keliuotis, Wm. M. Mercer Investment Consulting
Richard Boggs, Burnley Associates
Karen Franklin, National City Bank
Liz St. Clair, Carmel Clay Cafeteria Workers' Association
Doug Todd, McCready & Keene, Inc.
Don Hilt, PERF Retiree
E. William Butler, PERF Executive Director
Mark Webb, PERF Deputy Director & General Counsel
Diann Clift, PERF MIS Director
Patrick Lane, PERF Executive Assistant
William Hutchinson, PERF Division Director, Pension Administration
Dave Yeater, PERF Controller
Linda Stahl, Recording Secretary

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

A. Agenda of April 17 & 18, 2000 Meeting
B. Minutes:
    - December 9 & 10, 1999 Board of Trustees Meeting

- February 18, 2000 Board of Trustees Meeting
- January 19, 2000 Investment Committee Meeting
- March 7, 2000 Investment Committee Meeting

C. Statements of Retired and Disabled Members – PERF, Judges, Conservation & Excise, and Police & Fire

D. Reports, Summaries, Memorandums and/or Letters Concerning:

- Consolidated Retirement Investment Fund Quarterly Performance
- Quarterly Investment Compliance
- Quarterly Financial Statement
- Quarterly Statistical Statement
- Senate Bills 62 and 64
- Buildings Update
- Member Newsletter
- Trustee Workshops

A quorum being present, Vice Chair Turner called the meeting to order.

1. MINUTES APPROVAL

MOTION duly made and carried to approve the Minutes of the December 9 & 10, 1999 meeting.

Proposed by: *Steve Miller*
Seconded by: *Jonathan Birge*
Votes: *3 for, 0 against, 0 abstentions (Doermer & Ghilarducci absent for vote)*

MOTION duly made and carried to approve the Minutes of the February 18, 2000 meeting.

Proposed by: *Jonathan Birge*
Seconded by: *Steve Miller*
Votes: *3 for, 0 against, 0 abstentions (Doermer & Ghilarducci absent for vote)*

2. ADMINISTRATIVE

Executive Director's Report

a. Legislation Update

- Senate Bill 64 – Senate Bill 64, making PERF an independent body corporate and politic, was passed and signed by the Governor with an effective date of July 1, 2000. The bill essentially removes PERF from State government as such and gives control of budget, personnel and procurement issues directly to the Board of Trustees. The Board will handle those issues in accordance with their fiduciary duties.

- Senate Bill 62 – This bill was written to harmonize Indiana Codes with the Federal Tax Code to enable the capture of as much tax deductibility as possible with the police and fire line of duty deaths and disability payments. There has always been an issue between the recipients of these benefits and the Internal Revenue Service as to what is and what is not taxable. A Private Letter Ruling was received from the IRS in October 1999 providing a partial favorable treatment. On the basis of those negotiations, the Senate Bill 62 language was drafted, and a Private Letter Ruling follow-up will now be filed to secure the rest of the favorable treatment.

  A second part of Senate Bill 62 dealt with voluntary contributions for civilian PERF employees wherein a member can elect to contribute up to 10% above and beyond their normal 3% contribution. A Private Letter Ruling request will also be filed on this matter asking the IRS to determine that those contributions can be pre-taxed as opposed to post-taxed.

b. Internal Audit

The Board previously discussed putting together an internal audit project. The Budget and Audit Committee of the Board met to discuss the matter and decided to move forward with the firm of PricewaterhouseCoopers (PcW) on the theory that PcW was already familiar with PERF by virtue of their involvement in audits completed a couple of years ago. Also, that was a palatable alternative to the Department of Administration. However, a number of contractual issues have been encountered with PwC. They have asked for provisions that would give them fairly strong protections against such things as third party claims and outside damages. PERF is still exploring whether a common ground can be reached. If so, PcW will do actual internal auditing for PERF, setting up the functions and developing a manual of internal controls. After 8-10 months, the function would then be turned back over to PERF internally.

c. Reorganization

- Resolution - Following Board direction at the February 18 meeting, various discussions were undertaken to ensure that PERF employees would maintain uninterrupted benefit coverage under the State program with the passage of Senate Bill 64. Therefore,

  MOTION duly made and carried to adopt Resolution No. 00-03 authorizing the continuance of the State of Indiana benefit plans for PERF employees.

  Proposed by: *Jonathan Birge*
  Seconded by: *Steve Miller*
  Votes: *3 for, 0 against, 0 abstentions (Doermer and Ghilarducci absent for vote)*

- Staffing and Functions – A staffing plan is currently in the process of preparation for inclusion with a report (due November 1st) to PMOC, the Governor's Office and the Budget Committee. That report would detail the manner in which PERF's budget will be handled for the next fiscal year starting July 1, and then what is planned for development and prosecution of the budget every year thereafter. A major part of that budget for the first year will deal with staffing issues.

- Joint Projects – Historically, there has been conversation about PERF and TRF performing certain functions in a joint effort. In fact, the new computer project is being handled as a joint venture. Other areas of similar opportunity will be looked at (i.e., a call center, back office functions, contract monitoring) in an effort to save money for both Funds and their constituents.

Buildings Update

a. 125 West Market Street

Occupancy of the 125 West Market Street building for the 4th quarter of 1999 was 100%. However, as of April 1 the building became vacant with the departure of the Data Processing Oversight Commission. With some of the PERF/TRF transitional issues forthcoming, that space might well be utilized for some of those functions. Total Income and Net Operating Income for the building were significantly better than budgeted due to the collection of two months of base rent in November.

b. 143 West Market Street

Fourth quarter occupancy in the Harrison Building was 79% with full occupancy expected within the next two months or so. Total Income and Net Operating Income were significantly better than budgeted for the quarter due to multiple months of base rent collected in November. Total Operating Expenses and Net Operating Income were also significantly better than budgeted.

With respect to reconstruction efforts, the Pension Administration area has now been moved to its new home on the 7th floor. The Data Processing/Data Imaging/Records Management Departments will now be moved to the 8th floor as temporary housing until such time as more transition planning has been completed.

Member Newsletter and Quarterly Statement

The next issue of the member newsletter will include the following:

- Message from the Director
- Report on the new Clarety project and an explanation of the ramifications it will have on customer service in the future
- A formula for calculating a retirement benefit and an explanation of the two-part benefit structure
- Update on recently enacted statutory changes to the laws that govern PERF
- A history of the Fund's growth since its inception in 1946

Looking at the quarterly Member Statement of Account, steps are being taken to incorporate into the Statement the member's service credit detail. As the new computer system is up and running, a member's creditable service and the employer with whom it was worked will be incorporated into the Statement. Also to be included will be the member's beneficiary designation(s).

Year 2000 and SIRIS Update

The Year 2000 project went very well. Staff was on hand January 1, and there were no problems at all. A total of $1.4 Million was used in the Year 2000 assessment in repairing systems and those types of things.

The SIRIS project is also going very well. There are five stages of the project --- membership, benefits, ad hoc reporting (which would allow users to obtain informational reports from the system), dial-in (which would allow counselors to go out into the field and do counseling sessions all over the State), and implementation of PeopleSoft General Ledger. Currently, the project is at stage 2. Stage 1 has been designed and prototypes are now being shown with a scheduled rollout date of October 1. That will allow a lot of the membership processing to be done on the new system. In February 2001 benefits will be put online so that basically all current workflow will be shifted over to the new system. One thing also going on in conjunction with these efforts is a statutory compliance review of the system design.

A lot of forms and correspondence are being redesigned with a goal of producing documents that can be used jointly between PERF and TRF. Additionally, effort is underway to automate much of the correspondence so that documents can be generated with the touch of a button and without the need for a lot of typing. Hardware and software have been installed at the Department of Information Technology as well as at a data center in Columbus, Ohio. The Ohio center is where the SIRIS system will actually be maintained by CBSI.

A couple of other projects that have arisen out of the SIRIS project have to do with data cleanup and back file conversion. Data was previously rolled over into the current IRIS system, That data will now be rolled over again into the SIRIS system. In rolls outs of that nature, data tends to fall apart, and if you don't do a good cleanup job, data is incomplete. Thus, a team has been meeting for about 4-5 weeks doing a lot of problematic cleanup of the data. Eventually, efforts will have to be undertaken to obtain lost data. That will be an ongoing project that will take up to 3-5 years to complete. With respect to back file conversion, PERF currently has a lot of paper files that will be sent out for conversion to electronic images and microfiche so that there will be not only multiple copies but legal copies of the information. That, too, is an ongoing project that will start in approximately 30-45 days and will take 6-9 months to complete. All of this is the first step in getting aligned to be able to do business on the Web. This software/hardware will allow the security measures and data quality to be put in place for that next phase of improvement.

3. ACTUARIAL

Doug Todd, McCready & Keene, was in attendance to discuss the July 1, 1999 PERF actuarial valuation report (copy on file).

Looking at contribution breakdowns and comparisons, the total annual cost as a percentage of anticipated payroll for the State was 5% and 5.1% for the municipalities. The State had a $105 Million experience gain for the year and the municipalities $120 Million. Employee data (participants, beneficiaries, terminations) indicates little change from last year.

Contribution rates over the last few years have trended downward, with the 1999 State rate projected at 5.0%. The estimated annual rate of investment return for 1999 was 10.04% as a market basis and 9.52% on an actuarial basis.

Following discussion,

MOTION duly made and carried to accept the PERF actuarial valuation report as presented for July 1, 1999 and to set the State contribution rate at 5%.

Proposed by: *Jonathan Birge*
Seconded by: *Steve Miller*
Votes: *3 for, 0 against, 0 abstentions (Doermer and Ghilarducci absent for vote)*

4. LEGAL

Carmel Clay Schools

Representatives of the Carmel Clay School Corporation recently met with Mark Webb, Bill Hutchinson, and Mary Beth Braitman to discuss a proposal to amend their PERF Resolution to define a full-time position as one in which an individual works a minimum of 1,500 hours per school year. (Full time positions currently require a minimum of 1,000 hours, or 600 hours for teaching positions.) Additionally, Carmel

Clay wants to make the amendment applicable only to those individuals hired after January 1, 1999, which means that each time someone who was hired prior to that date quits and another individual is hired, that position would automatically move from covered to non-covered.

On March 30 a telephonic meeting was conducted with Carmel Clay's Director of Personnel, Business Manager and Legal Counsel; Mary Beth Braitman; Mark Webb; and Bill Hutchinson. At that time Carmel Clay was informed that there is a statutory way to withdraw certain individuals from PERF coverage and their proposal did not comply with that procedure. They responded that they would like the opportunity to go back and submit such a proposal, and that proposal was received late last week. Hopefully, staff will be able to bring satisfactory resolution of the matter before the Board at its next meeting.

<u>McCray Memorial Hospital</u>

By way of review, representatives of McCray Memorial Hospital previously met with the Board of Trustees requesting relief of an approximate $1.8 Million obligation in unpaid employer contributions dating back to 1996. That request was made in light of the fact that McCray was over funded in their employer reserve account by about $5 Million. After reviewing the situation, the Board recognized that essentially as of December 31, 1999, McCray Hospital would be non-existent. Based upon that fact, PERF staff was delegated the authority to obtain the best possible resolution of the matter.

Thus, Mark Webb reported that effective December 31, 1999 McCray Memorial Hospital did, in fact, cease to exist and all their employees were hired by Parkview Hospital. However, their sale to Parkview has not been completed due to a number of regulatory reasons. That sale is scheduled for completion on April 30 providing all regulatory approvals are then met. If not, the sale will be rescheduled every 30 days until such time as those approvals are met. Based upon the unusual facts of this situation, PERF requested that their actuary recalculate McCray's obligation as a possible way of resolving the matter. The payroll for that period of time was approximately $43 Million and because McCray was over funded, their rate, had it been known they would be over funded and would continue that way, would have been zero. However, because of a smoothing rule applied to such calculations, the minimum contribution rate would have been 1%. Therefore, it is staff's recommendation that settlement be sought based upon a 1% contribution rate. While PERF does not want to set a precedent in relieving such obligations, staff feels the circumstances of this case merit such a resolution.

New/Pending Litigation

Mark Webb apprised the Board of current/pending litigation as follows:

a. A suit filed against PERF last spring involving a firefighter with one glass eye. By definition the sight in that eye is zero, and this individual does not, therefore, meet the minimum sight qualifications in an unaided eye. Recently the 7th Circuit Court of Appeals in Chicago ruled in a similar case that a state is entitled to immunity for suits filed under the Americans with Disabilities Act (ADA). Based on that ruling, Mr. Webb was given notice by the Attorney General's Office that this plaintiff will be dismissing PERF with prejudice. That will be the last remaining police and fire case under the ADA. There are other cases in the hopper in administrative stages, but this is the only case currently pending in a court of law.

b. A case in Evansville involving two individuals who did not meet the mental baseline standards as determined by the City of Evansville. In pretrial conference, it was agreed that this is a matter that will have to be resolved at the local level since those baseline standards are determined by the City of Evansville and not PERF.

c. A suit involving the Conservation & Excise Police Officers' Fund. In 1998 PERF was sued by a group of retired officers indicating that PERF had improperly calculated benefits on the Fund since its inception in 1972. In December 1999 the Court in Jennings County heard arguments and ruled against PERF. PERF sought and received a Stay of Execution for the judgment. Thus, the case is on appeal to the Indiana Court of Appeals, and they have yet to issue their briefing schedule. If the Court rules that the Judge was wrong, the case is over. However, if the Court rules that PERF was wrong, the case will then go back to trial to determine the damages.

5. RECESS

With no further business, the meeting was recessed to reconvene at 8:30 a.m. on April 18.

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Richard Boggs, Burnley Associates
Karen Franklin, National City Bank
Matt Brase, Indiana Association of Cities & Towns
E. William Butler, PERF Executive Director
Mark Webb, PERF Deputy Director & General Counsel
Patrick Lane, PERF Executive Assistant
Linda Stahl, Recording Secretary

1. INVESTMENT POLICY STATEMENT

Mary Beth Braitman noted that the Investment Committee had met on April 17 to finalize changes to the Investment Policy (copy on file). The most significant changes involved the following:

SECTION 6. ASSET ALLOCATION

Target Allocations - Inclusion of allocations as determined by the Board of Trustees.

SECTION 8. INVESTMENT GUIDELINES

Prohibited Securities and Transactions – Significantly rewritten with the inclusion of characteristics of prohibited securities rather than an itemization of prohibitions. Municipal securities were deleted with the addition of a specific prohibition on inverse floaters.

Asset Class Inventory – Changed to reflect the new asset classes as determined by the asset/liability modeling study. A separate class for securities lending cash collateral reinvestment was added. However, rather than trying to incorporate the restrictions and risk controls in the Investment Policy, it was decided that the best thing to do would be to bring those guidelines to an Addendum.

Portfolio Guidelines – The guidelines for the specific portfolios were significantly rewritten with the overall concept of trying to make the guidelines fairly broad in expressing the intent of a specific portfolio rather than itemizing a list of prohibitions. At the same time, more detail was included as to the manner in which a specific portfolio is supposed to function.

MOTION duly made and carried to accept the proposed Investment Policy revisions as discussed.

Proposed by: *Steve Miller*
Seconded by: *Jonathan Birge*
Votes: *3 for, 0 against, 0 abstentions (Doermer & Ghilarducci absent for vote)*

2. INVESTMENTS

Investment Committee Report

Steve Miller reported that the Investment Committee had met on three different occasions since the last Board meeting, those being January 19, March 7, and April 17. During the January 19 meeting the matter of securities lending was discussed. At that time it was Mercer's recommendation that PERF retain both securities lenders (Bank One and Chase) and that the lending pools be made more equitable between the two with a split of $2.5 Billion to Chase and $1.5 Billion to Bank One. It was also recommended that there be a harmonization of the two contracts and development of cash collateral guidelines. Those issues will be matters for Board discussion at its next meeting.

At the March 7 meeting, Investment Policy revisions were discussed as well as the matter of due diligence with respect to investment manager reviews. Discussion was undertaken on the manner in which that should be accomplished with Mercer proposing two approaches:

a. Board delegation of the review function to the Investment Committee. Ongoing due diligence would be conducted through the review and advice of the Fund's consultant through quarterly reports with periodic presentations to the Investment Committee.

b. Board control of the review function. Ongoing due diligence would be conducted through the review and advice of the Fund's consultant through quarterly reports with periodic presentations to the Board.

Following Board discussion of the matter,

MOTION duly made and carried that the due diligence function be delegated to the Investment Committee with the day-to-day activities referred to the Fund's consultant.

Proposed by: *Jonathan Birge*
Seconded by: *Steve Miller*
Votes: *3 for, 0 against, 0 abstentions (Doermer and Ghilarducci absent for vote)*

Also an agenda item at the March 7 meeting was the asset/liability modeling study conducted by Mercer on both PERF and the Police & Fire Fund. Committee discussed adopting the same target asset allocations for both Funds due to their similarities and liability structures. Recommendations were made for implementing the revised asset allocation targets as follows:

PERF/Police & Fire

a. Increase the overall domestic equity allocation to 55% from the current 50%. An alternative investment target of 2% would be included within the domestic equity allocation.
b. Keep the international equity target allocation unchanged at 10%.
c. Decrease the core-fixed income allocation to approximately 35%, but with that 35% there would be an inflation-indexed bond allocation of 5% with an initial implementation step of 2%. Also, an initial 3% of the core-fixed income allocation would go to real estate.

(These recommendations were voted upon by the Board earlier this date in the approval of the revised Investment Policy.)

<u>Pension Relief</u>

a. Adopt a 30% equity/70% fixed income target for the Pension Relief Fund and allow Barclays Global Investors to manage both portions.

Following Board discussion,

MOTION duly made and carried that approximately 30% of the assets of the Pension Relief Fund be moved to the Barclays Global Investors' equity index through approximately $50 Million per month transfers until such time as there is 30% funding. The fixed income assets will remain in an intermediate index fund.

Proposed by: *Steve Miller*
Seconded by: *Jonathan Birge*
Votes: *3 for, 0 against, 0 abstentions (Doermer and Ghilarducci absent for vote)*

Another topic of discussion within the asset/liability modeling study concerned the determination of the interest crediting rate for the Annuity Savings Account (ASA) Guaranteed Fund. The study showed that the Guaranteed Fund rate does not place the rest of the Fund at risk. Thus, it was recommended that on an annual basis the rate be reviewed with the minimum rate being the actuarial return of the Fund plus some margin above that return based on market conditions. Following Board discussion and based upon Mercer's study,

MOTION duly made and carried to set the Annuity Savings Account Guaranteed Fund Rate for the fiscal year ending June 30, 2001 at 8.25%.

Proposed by: *Steve Miller*
Seconded by: *Jonathan Birge*
Votes: *3 for, 0 against, 0 abstentions (Doermer and Ghilarducci absent for vote)*

With respect to the April 17 meeting, Committee met with Brinson Partners concerning their performance and some organizational changes. Brinson detailed to the Committee a new portfolio strategy they would like to implement in the PERF portfolio with Board approval. Currently, Brinson looks at the 500 stocks available and drops off any portion of them they feel are overvalued. The basic change in the process would be to make a combination quantitative/subjective judgment on whether to underweight some sectors and overweight others. The problem in switching to the new procedure would be that the shortfall experienced over the last year or so would not be regained should the value stocks have a huge rally. If the Fund continues to use the current strategy and the value stocks rally, it is conceivable that the shortfall could be made up. Following further Board discussion,

MOTION duly made and carried that the PERF portfolio be switched to the new Brinson strategy. That switch is to be accomplished by initially moving half of the portfolio and subsequently moving the remainder of the portfolio over the ensuing 3-6 months.

Proposed by: *Steve Miller*
Seconded by: *Jonathan Birge*
Votes: *3 for, 0 against, 0 abstentions (Doermer and Ghilarducci absent for vote)*

Committee discussion at the April 17 meeting also concerned Conseco Capital Management and how recent events within the parent organization might affect Conseco Capital Management. Concern rests in how the investment portfolio managers are compensated --- whether they are compensated with a bonus based upon the overall performance of the Conseco organization itself or whether it's based solely upon what they do at Conseco Capital Management. The risk being that if their performance is based on the corporate Conseco and the bonuses dry up, some of the talent at Conseco Capital Management could be lost. Following Board discussion of this and other potentially similar issues,

MOTION duly made and seconded to delegate to the Investment Committee the authority to immediately suspend/terminate any manager until such time as a Board meeting can be convened.

Proposed by: *Steve Miller*
Seconded by: *Nancy Turner*
Votes: *3 for, 0 against, 0 abstentions (Doermer and Ghilarducci absent for vote)*

Performance Analysis Report

Pete Keliuotis summarized 4th quarter performance (report on file) by noting that economic growth was very strong, continuing the trend seen for the past several quarters. As a result, equity markets again had a very strong quarter. Concerns of rekindled inflation continued to raise interest rates so that since October 1998 rates have gone up by about 130 basis points. Those managers who had either long or short duration spans didn't find that it really affected their performance much. However, those managers who aggressively looked at the yield curve structure and took advantage of changes there did quite well.

International equity markets by in large did quite well with the top performing European markets being Finland, Germany, and Sweden. Ireland and Austria were the 4th quarter laggards. On the currency side, the dollar weakened a little relative to the yen, but it was stronger relative to the Euro countries. The emerging markets also experienced a fourth quarter rally, as Latin American countries, Russia and Turkey posted outstanding gains.

With respect to the fixed income markets, shorter maturity strategies had about a 1.3% return over the quarter and high yield bonds did very well at 1.6%. Interest rates moved higher during the quarter, capping the worse year in the bond market since 1994. Managers who focused on higher yielding bonds amid general market weakness were rewarded. Corporate bonds benefited from the strong economy and a small supply of new issuances.

Looking specifically at the allocation of funds within the Consolidated Retirement Investment Fund (CRIF), total Fund assets were about $10 Billion with 47.1% in large cap equity, 7.7% in small cap equity, 43.0% in fixed income and the remainder in a Reallocation Fund. As the market environment was favorable to all equity classes during 1999, the Fund experienced gradually increasing exposure to both large and small equities. Fixed income exposure declined during the year, down from nearly 60% of the Fund at the end of the 1st quarter to 44.1% at the end of the 4th quarter.

Investment Compliance Report

Dick Boggs summarized the managers' investment compliance (report on file) by noting that all managers appeared to be following the styles for which they were hired. The only violation detected had to do with sector over-allocations, which could be attributable to transfers associated with the establishment of new manager portfolios.

Steady progress continued to be made to achieve the long-term asset allocation goals of the Fund. The allocations on December 31 were 47% large cap domestic equities, 8% small cap domestic equities, and 45% domestic bonds.

Securities lending efficiency and income generation had dropped, offsetting only 25% of fees versus 30% last year. No violations of guidelines were detected except those of over concentration, which are explainable by the liquidation of the bond portfolios.

Commissions averaged below 3 cents per share. The S&P Index trades were at 1.5 cents, the large cap enhanced indexers at 3-4 cents, and the small cap at 4-5 cents. Those ranges are all within the acceptable ranges for large institutional portfolios.

3. NEXT MEETING

The next meeting of the Board was previously scheduled for June 8 and 9, 2000.

4. ADJOURNMENT

There being no further business, the meeting was adjourned.